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SENSITIVE

WHA FOR WHA/BSC AND WHA/EPSC
E FOR THOMAS PIERCE,
PASS NSC FOR JOSE CARDENAS
PASS FED BOARD OF GOVERNORS FOR PATRICE ROBITAILLE
PASS USTR FOR SUE CRONIN AND MARY SULLIVAN
TREASURY FOR ALICE FAIBISHENKO
USDOC FOR 4322/ITA/MAC/OLAC/PEACHER
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SUBJECT: ARGENTINA'S FINANCIAL SERVICE PLAYERS ON CAPITAL MARKETS,
FINANCIAL INTERMEDIATION

Ref: Buenos Aires 2598

Summary

[1](#)1. (SBU) Senior Argentine financial sector representatives outlined to Ambassador their concerns about lagging development of domestic capital markets. While optimistic about Argentina's medium term growth prospects, they questioned whether existing channels of financial intermediation can sustain levels of investment required to maintain high real GDP growth. End Summary

[1](#)2. (SBU) On November 27, Ambassador met with representatives of Argentina's financial sector at a breakfast hosted by the Center for Financial Stability (Centro para la Estabilidad Financiera, CEF) to review the development of local capital markets. A cross section of senior representatives of financial services institutions (banks, bank chambers, insurance companies and pension funds) corporate financial executives, and congress (including the chairman of the lower house finance committee) attended.

[1](#)3. (SBU) Discussion focused on participant concerns about the lagging development of long term debt instruments in domestic capital markets and whether existing formal channels of financial intermediation can sustain the levels of investment required to maintain high GDP growth rates. While post-crisis Argentine investment levels have recovered to 21-22% of GDP, many questioned the quality of such investment; a significant share of new investment has been channeled into real estate development that does not significantly add to Argentina's productive capacity. There was general agreement that investment at the 25-26% of GDP level will be required to underpin sustainable 5-6% medium term real GDP growth.

[1](#)4. (SB) Bank and bank chamber representatives emphasized that, while

bank balance sheets and overall liquidity have improved considerably since the depth of the 2001/2002 economic crisis, they remain highly exposed to both currency and maturity portfolio mismatch, with no market instruments available to hedge long term exposures. One consequence has been the slow and limited development of a domestic mortgage market. Representatives of insurance companies and private pension funds were upbeat, explaining that the concentration of GoA bonds in their portfolios was steadily declining and that expanded GoA use of fiduciary funds to facilitate energy sector infrastructure investment could offer attractive domestic investment opportunities (Reftel).

CEF Background

15. (SBU) CEF, the Center for Financial Stability, is a financial service sector public policy think-tank established in 2002. Its post-economic crisis focus is on the non-partisan analysis of the regulatory structure of public finance, a highly politicized area of public discourse under the Kirchner administration. Through a program of policy notes, seminars and training, CEF works to facilitate the exchange of information and opinions among policy makers, regulators, market players and consumers of financial services.

Comment

16. (SBU) A worthwhile meeting with players in the financial service sector. Think-tanks like CEF play a key role in strengthening Argentine civil society by serving as a forum for private-public sector discussion of critical economic and social issues, including on strengthening institutions. This is important at a time when

Argentina needs to continue building institutional capacity to pave the way to sustainable growth.

17. (SBU) Argentina's financial system is recovering, but still remains fragile. Banks are reporting profits but remain undercapitalized and subject to systemic risk. In addition, there is still considerable forbearance, allowing banks to deviate from generally acceptable international accounting practices. Ultimately, financial sector development in Argentina is tied to the quality of GoA economic stewardship. The IMF writes: "... the recovery of the banking system will depend critically on continued improvements in the macroeconomic environment, the resolution of policy-induced losses, and on a return to an institutional environment that promotes sound banking practices."

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